MINUTES
of the
SECOND MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

July 8-9, 2014
Zia Conference Center, Room 55400
Health & Human Performance Center
San Juan College
Farmington

The second meeting in 2014 of the Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Representative Edward C. Sandoval, chair, on Tuesday, July 8, 2014, at 10:11 a.m. in Room 55400 of the Zia Conference Center of San Juan College in Farmington.

Present
Rep. Edward C. Sandoval, Chair
Sen. Carlos R. Cisneros, Vice Chair
Rep. Anna M. Crook
Rep. Rodolpho "Rudy" S. Martinez
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Rep. Bob Wooley

Absent
Sen. Sue Wilson Beffort
Rep. Brian F. Egolf, Jr.
Sen. Timothy M. Keller
Sen. Mark Moores
Rep. Henry Kiki Saavedra
Sen. Lisa A. Torraco
Sen. Peter Wirth

Designees
Rep. Donald E. Bratton (7/9, participating as a member of the Legislative Finance Committee (LFC))
Sen. William F. Burt
Sen. Nancy Rodriguez
Rep. Carl Trujillo (7/9, participating as a member of the LFC)
Rep. Luciano "Lucky" Varela (participating as a member of the LFC)

Sen. Jacob R. Candelaria
Rep. Ernest H. Chavez
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Jason C. Harper
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Rep. Bill McCamley
Sen. George K. Munoz
Rep. Paul A. Pacheco
Rep. Dennis J. Roch
Rep. Debbie A. Rodella
Sen. John M. Sapien
Sen. Pat Woods

(Attendance dates are noted for members who did not attend the entire meeting.)

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Michelle Jaschke, Researcher, LCS
Tessa Ryan, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Tuesday, July 8

Impacts and Issues of Trade Areas: Farmington and San Juan County

Tommy Roberts, mayor, City of Farmington, opened by inviting those present to visit area attractions and noting that several representatives from the City of Farmington were in attendance. Joining Mayor Roberts were Rob Mayes, city manager, City of Farmington, and Kim Carpenter, county executive officer, San Juan County. The three discussed commerce-related issues, including the tax base, trade and effects of the phase-out of hold harmless payments.

Mayor Roberts summarized the city's recent gross receipts tax (GRT) revenue history. He explained that the substantial decline in GRT revenue has been due in large part to the drop in price of natural gas and the resulting loss of jobs in that sector. Though it is hoped that the Mancos shale oil play will continue to fuel an increase in jobs and total GRT revenues, Mayor Roberts noted that GRT revenues still fall below the high-water mark reached in fiscal year (FY) 2009.

Mayor Roberts highlighted some of Farmington's attributes, particularly its status as a retail trade center for a large population that attracts nonresident spending. The federally defined trade area spans six New Mexico and Colorado counties and consists of over 220,000 people, but Mayor Roberts noted that the trade area can be considered larger than that. He added that the city's GRT rate is lower than that of area cities, giving Farmington a competitive edge in commerce. Because, on the whole, its residents favor a fiscally conservative government, Farmington has consistently elected to refrain from imposing several local option GRT increments.

Moving on to a discussion of the city's GRT rates and the effects of recently enacted changes to the hold harmless scheme, Mayor Roberts outlined several scenarios related to the city's taxing potential and the impending phase-out of hold harmless payments. He reviewed a chart showing hold harmless payments, which generally have increased steadily over time, to the city. He also illustrated the effect of a hypothetical implementation of the city's and county's exercise of their full hold harmless taxing authority. That implementation would raise the current total GRT rate by more than 10% and make the area less commercially competitive. If the city implemented a one-eighth increment in FY 2016, the cumulative effect of that increase and the cumulative effect of the reduction in hold harmless payments would be reconciled, i.e., the city would break even in FY 2026. Mayor Roberts compared that to other break-even scenarios — a two-eighths increase and a three-eighths increase — and noted the points at which the net loss from the hold harmless phase-out would exceed the revenue gained through implementing the tax increments. Lastly, Mayor Roberts commented that factors such as a city's relative dependence on the GRT for revenue or its promise for future growth are more meaningful considerations than its size in determining how the law should treat cities disparately in the hold harmless scheme. He added that he supports the potential return of food and medicine to the GRT base and acknowledged that lawmakers face difficult decisions in this area in their attempts to reconcile divergent interests.

Mr. Carpenter began his address to the committee by identifying other representatives of San Juan County in the audience. He then provided an overview of the county's fiscal status. After revenues declined as a result of the economic slump and the recent removal of two power plants and two mines from the tax rolls, the county has striven to reduce its budget without cutting services. Mr. Carpenter expressed concern for other potential losses and encouragement by the possibility of a new clean-energy power plant's siting in the county. Mr. Carpenter added that the county is reluctant to impose new taxes, but the passage of recent state legislation — Senate Public Affairs Committee Substitute for Senate Bills 268 & 314 and Senate Finance Committee Substitute for Senate Bill 368, as amended (partial veto), 2014 (Chapter 79) (SB 268) — affecting what are formerly sole community provider hospitals applies pressure to do so.

On questioning, Mayor Roberts, Mr. Mayes, Mr. Carpenter and committee members addressed the following topic.

Economic development-related legislation and area economic development. Mayor Roberts said that the city has not yet thoroughly analyzed opportunities for economic development created by other laws but that it is trying to stimulate its economy by attracting more economic base jobs. Mr. Carpenter noted that inadequate infrastructure poses challenges for economic development; nevertheless, there has been a recent upswing in jobs and hiring. A committee member lamented the low accuracy of information about legislative proposals that often marks Taxation and Revenue Department fiscal impact reporting and that results in unforseen revenue loss. The member also recommended that, given the high volatility associated with oil and gas-related revenue, policymakers whose governments depend heavily on that revenue diversify their income streams and act in fiscally responsible ways. Another committee member commented on the challenges for area economic development posed by federal laws and processes, such as in the area of rig permitting.

Impacts and Issues of Trade Areas: Gallup and McKinley County

Jackie McKinney, mayor, City of Gallup, George Kozeliski, acting city manager, City of Gallup, and Bruce Swingle, county manager, McKinley County, presented an economic profile of Gallup and McKinley County and the predicted effects of recently enacted hold harmless legislation.

Mayor McKinney discussed the Gallup trade area, its GRT rates and revenue, its hold harmless payments and the anticipated effects of enacting hold harmless tax increments. The trade area includes McKinley County and portions of Arizona, the Navajo Nation and the Pueblo of Zuni. Gallup has a high sales volume — approximately $430 million annually — but only a little more than one-half of that is taxable. The city's GRT revenue has been, and is predicted to remain, flat. It receives about $3.1 million in hold harmless payments and would lose much of that if it imposed the maximum hold harmless increment. Further, if it and McKinley County imposed the maximum tax allowed by the hold harmless scheme, then Gallup's tax rate would be the highest on the Interstate 40 corridor.

Mayor McKinney explained his reasons for believing that imposing that maximum increment would be problematic. First, the county has an inordinately high poverty rate and the lowest per capita income of any county in the state. It also receives many nonresident visitors who use but do not pay for services to the extent that residents do. Gallup also has a lot of crime and needs to maintain, if not increase, its police and fire-protection forces to manage crime and emergencies. Collectively, these conditions demand a high level of costly services that should not be reduced. Therefore, budget cuts are not an acceptable solution, nor is raising the GRT rate. If it were, the largely impoverished population and the local economy would be further stressed.

Mayor McKinney proposed a state-sponsored solution to Gallup's difficulty. The state could reinstate hold harmless payments for cities and counties that are characterized by disproportionately high poverty rates. Given that no other local government's size and poverty characteristics match those of Gallup and McKinley County, the solution could be tailored to assist only these governments, thereby avoiding excessive financial strain.

Mr. Swingle discussed McKinley County. McKinley County has a disproportionate share of the state's people living in poverty. Further, a majority of the county's land is nontaxable. Although the county receives some federal payments in lieu of taxes, it is not known whether the federal government will continue those payments. Mr. Swingle also talked about the county GRT rate and noted that, though it is not the highest in the state, it is higher than the corresponding tax rate of the Arizona county it competes with for retail trade. Most of the county's revenues are generated from the GRT. Mr. Swingle added that the county's economy has weakened in recent years. The number of business licenses, employees and employers have decreased. Because of competition with the neighboring Arizona county, the commission is reluctant to increase McKinley County's GRT rate.

On questioning, Mayor McKinney, Mr. Kozeliski, Mr. Swingle and committee members addressed the following topics.

Regional crime. Alcohol abuse fuels a lot of crime, and domestic violence is prevalent. Regional crime is further attributable to the intermittent influxes of people from outlying areas. A member pointed out that, conversely, such influxes are an economic boon.

Lost wealth in region. Federal sequestration and the recession have taken a heavy toll on the region, once widely believed — erroneously — to be home to a high number of wealthy people.

Fairness and Equity in State Tax Incentive Policies for Economic Development

Ed Flynn, chief operating officer, International Wire Group (IW), testified on his business's concern about the prospective siting of another bare copper wire manufacturing company in proximity to IW's facility in Santa Teresa. The concern centers on the state's and Dona Ana County's efforts to provide financial incentives for the competing company, CN Wire Corporation (CN Wire), to open that facility and the unfair business advantage for CN Wire that he said would result. Mr. Flynn was accompanied by Dr. David Schauer, associate professor of economics and finance, University of Texas at El Paso (UTEP), and Dr. Byron Schlomach, director, Center for Economic Prosperity, Goldwater Institute.

Mr. Flynn described the situation, which he characterized as marked by unfairness in tax policy. He outlined the subsidies offered by the state and county to CN Wire, which include Local Economic Development Act (LEDA) funding, Job Training Incentive Program (JTIP) funding and tax abatement through industrial revenue bond (IRB) financing. These subsidies, if given, would be detrimental to IW's business by giving IW's direct competitor an unfair advantage over it. In response to recent developments, IW requested through a provision of law (Section 4-59-15 NMSA 1978) a reconsideration of the IRB issuance; Mr. Flynn said that IW wishes to get a full evidentiary hearing before the State Board of Finance. He continued by giving the background of IW's 2011 establishment in Santa Teresa, stressing that the company received no county or state subsidy in connection with the venture. IW, he said, has since saved and created jobs and made substantial investments.

Mr. Flynn testified that he believes that CN Wire failed to submit complete information in its application to receive benefits through the LEDA program. In the application, the company understated its business competition, he said, and the application was completed by a biased entity and within a confidential process that makes it difficult for existing companies to timely protest an applicant's receipt of benefits. When he expressed his concerns to the secretary of economic development, Mr. Flynn was told that IW could similarly capitalize on state-offered incentives by closing its facility and opening a new one, or it could apply for benefits through the JTIP, the high-wage jobs tax credit or both.

Mr. Flynn concluded by urging the committee to examine the laws that entice new businesses to locate in the state and the lack of protections for existing businesses — specifically, the law that provides recourse for a potentially injured party to challenge the issuance of county — but not municipal — IRBs. He remarked that tax incentives pick winners and losers and undermine free market enterprise, and he questioned the message that government sends when it helps certain businesses while putting at a competitive disadvantage others that make entirely private investments. Lastly, he drew the committee's attention to several public statements in support of IW's plight.

Dr. Schauer, who was hired by IW to conduct an economic impact analysis of CN Wire's planned project, described his analysis and conclusions and noted that those conclusions represented his opinion, not that of UTEP. For his study, he used an input/output model to measure the likely economic effects relating to jobs, compensation and business volume. He studied the project's potential direct, indirect and induced effects and compared his results to those of the entity that CN Wire hired to help complete its applications for incentives.

Dr. Schauer argued that CN Wire's analysis relied on faulty assumptions that led to inflated conclusions about the project's economic effect on New Mexico. He pointed out that the company's proximity to El Paso would result in many of its workers living, and therefore spending much of their earnings, in Texas. Likewise, CN Wire would purchase much of its raw materials from Texas. He added that his analysis did not consider "substitution effects", which would further diminish the economic gain that New Mexico stands to reap.

Dr. Schlomach testified next, expressing the view that governments' direct subsidies and tax benefits for corporations are harmful for long-term prosperity. He argued that the long-term costs of such programs, which create market distortions, are higher than their short-term benefits. For one thing, unintended consequences could result from a government's giving. Further, such giving might send businesses the message that the location under consideration holds little appeal without the enticement. Lastly, it increases the burden on non-recipient entities, who must then shoulder the increased costs of infrastructure. Dr. Schlomach recommended that governments focus instead on creating a fair tax policy, a secure legal system and a sound infrastructure and that New Mexico end its tax incentive programs. He said that economies should be developed by helping businesses with permitting and by promoting the community.

On questioning, Mr. Flynn, Dr. Schauer, Dr. Schlomach and committee members addressed the following topics.

New Mexico's extricating itself from its tax system. Dr. Schlomach acknowledged a committee member's concern that, in the process of effecting broad tax reform, the state might harm the industries relying on existing benefits. He recommended that, were the state to undertake such reform, the state honor its existing commitments but repeal its tax incentive laws going forward. He added his opinion that most companies do not base their location decisions on tax benefits anyway, but rather more broadly on a state's overall policies.

IW's predicament and views. Mr. Flynn recommended that policymakers consider strengthening the LEDA application to more effectively solicit information about direct competition, which the legislature, in passing IRB laws, saw as being contrary to those laws' intended purposes. Dr. Schauer recommended that governments more assiduously collect complete answers to application questions and that they make their incentive award decisions based on complete data sets that accurately reveal the benefits of the award. A committee member commented that the state should actively seek a solution that is mutually agreeable to the companies. Another committee member recommended reconsidering laws related to IRBs. Mr. Flynn said that the State Board of Finance would meet next on July 15 but that an agenda had not yet been published, and so he did not know whether the issue would be addressed then.

Approval of Minutes

On a motion made and seconded, the minutes from the June 6, 2014 meeting were unanimously approved.

Revised 2014 New Mexico Business Tax Competitiveness Study

Richard Anklam, president and executive director, New Mexico Tax Research Institute (NMTRI), spoke about the findings of an updated report on the state's business tax competitiveness. He began by reviewing NMTRI-identified principles of good tax policy and describing the context of his presentation. The updated report was produced after Ernst & Young conducted a study of the 50 states and District of Columbia comparing the competitiveness of those entities' business taxes.

In the original study, Ernst & Young ranked New Mexico last for effective tax rate return on investment for a 30-year investment. Mr. Anklam stressed that the study was flawed in that it did not consider incentives or other factors contributing to a given business's site selection or overall cost, it used simple corporate income assumptions and it failed to overcome the difficulty of modeling New Mexico's GRT.

The NMTRI then commissioned Ernst & Young to conduct a follow-up study. In it, Ernst & Young compared New Mexico to eight other states, taking tax incentives into account, adding a rural location, adding industries and asking additional policy questions. The corresponding report stated that, without incentives, New Mexico's effective tax rate was the highest in all sectors. Mr. Anklam reviewed charts that illustrated in more detail how New Mexico compared with those other states in tax-specific areas. Mr. Anklam then pointed out that, with incentives considered, New Mexico's rankings in different areas were varied, though generally unfavorable. He reviewed charts that illustrate New Mexico's place among states by industry and investment type and a chart illustrating where, the study found, New Mexico would rank if particular tax policies were implemented.

Mr. Anklam said that some of those tax policies have been enacted in recent years. Namely, in 2012, lawmakers addressed the tax pyramiding issue by expanding the deductions for manufacturing inputs and construction services and by creating a new deduction for leasing equipment. Mr. Anklam highlighted New Mexico's ranks by industry after the implementation of that 2012 legislation. He pointed out that another policy had been adopted through passage of 2013 legislation, which, among other measures, phased in a reduced corporate income tax rate and allowed manufacturing companies to calculate their income tax using a single-weighted sales factor.

The NMTRI commissioned Ernst & Young in November 2013 to again analyze New Mexico's business tax competitiveness in light of these policy enactments and related changes in other states. Mr. Anklam reviewed the results, by sector and industry and before and after credits were considered, of that study. After credits were considered, New Mexico had the lowest effective tax rate for manufacturers but was less competitive outside of that sector. Meanwhile, its industry-specific rankings spanned a wide range.

On questioning, Mr. Anklam and committee members addressed the following topics.

Tax reform. A committee member commented that New Mexico's tax system is competitive, but complicated and poorly marketed, and that it picks winners and losers, making it unfair. Mr. Anklam suggested that, if policymakers wished to repeal incentives to make the system more equitable, incentives be carefully evaluated and reviewed so that policymakers would know which add net value to the state and might be worth preserving. He added that broad reform could be achieved incrementally so as not to significantly disrupt revenue streams. A committee member expressed the view that broad reform should be accomplished all at once but acknowledged that such an approach carries risk.

Comprehensive review of the GRT. Mr. Anklam described the status of a state tax study that he and Jim O'Neill, consultant, O'Neill Consulting LLC, have proposed conducting. He and Mr. O'Neill have been asked to produce a work plan, which would be available by the next meeting, and he would soon know better the costs of conducting the study. Much of the work would involve grasping the size of the tax base. To accomplish this, the two would collect publicly available information. To a lesser extent, they would need to rely on experts in related state agencies. Mr. Anklam said that after the fact-finding stage is complete, policymakers should take time to carefully mull options for reform.

Fiscal Impacts of Oil and Natural Gas Production in New Mexico

Mr. Anklam reported on the oil and natural gas industries' recent contributions to state revenue. He and Laird Graeser, primary research contractor, completed a preliminary study on the topic in February 2014. Mr. Anklam described the approach to answering the question ("How much does the oil and gas industry contribute to the state and local governments, schools, etc.?") as an objective, primarily data-driven attempt to quantify direct contributions to beneficiaries, not indirect contributions to the general economy. To gather information, Mr. Anklam and Mr. Graeser studied GRT, corporate income tax and personal income tax revenues associated with the North American Industrial Classification System's oil and gas codes. They also attempted to determine how much money from the oil and gas industries enters the Severance Tax Permanent Fund (STPF), the Land Grant Permanent Fund (LGPF) and other repositories.

Mr. Anklam summarized the results of the study. Revenue from the oil and gas industries constitutes a substantial portion of all revenue flowing to the STPF and the LGPF and a significant amount to the general fund and for public school, higher education and severance tax bond funding. He cautioned that, because oil and gas revenues are volatile and finite, it is particularly risky for the state to depend to such a large extent on them to replenish its general fund and support its local governments.

Mr. Anklam noted that the report is available on the NMTRI web site, that the first 32 pages, in particular, are helpful to read and that he welcomes readers' responses to it.

The committee recessed at 3:59 p.m.

Wednesday, July 9

The committee reconvened for a joint meeting with the LFC at 8:20 a.m. on Wednesday, July 9, 2014, with Representative Varela chairing the meeting.

Welcoming Remarks

Dr. Toni Hopper Pendergrass, president, San Juan College, welcomed the committees. She cited some statistics related to the college's population, summer enrollment and demographics. She thanked the legislature for its financial support of the new School of Energy, which she said would make important contributions to the state's economic development. Mr. Carpenter also welcomed the committees and gave a brief overview of the area.

Energy Economic Outlook

Dr. Helen Currie, senior economist, Conoco Phillips Corporation, presented on three main topics: economic fundamentals; the outlook for natural gas markets; and the outlook for oil markets. She said that advocacy for free trade was at the core of her message.

Economic Fundamentals

Dr. Currie characterized recent per capita gross domestic product levels as reflective of a long recovery from a long recession. She noted that there has been solid continuous economic growth, particularly in the U.S., fueled largely by the U.S. energy industry. Global income now exceeds pre-recession levels. Manufacturing in the U.S. has increased, in large part because of the growth in supply of North American gas and oil. That growth builds confidence in manufacturers that they can safely locate in the U.S.

Outlook for Natural Gas Markets

Much of the growth in energy production is attributable to shale gas, which returned the U.S. to its former place at the center of world energy markets, and the production scale of which had been unforeseen. The U.S. and Canada have enough shale resources to both meet their domestic demands and export a substantial amount without, according to industry experts, there being a substantial price increase. Much of the future shale growth will be concentrated in the eastern U.S. and western Canada. Dr. Currie noted that New Mexico will benefit from the increase in net exports to Mexico.

Dr. Currie reviewed charts showing that the greatest demand for U.S. natural gas between 2013 and 2020 is predicted to be in the liquefied natural gas exports sector and that the West South Central region of the U.S., because of its predicted energy-intensive manufacturing growth, will have the highest growth in demand for natural gas between 2013 and 2030. She noted that natural gas liquids are a key component in revitalizing the U.S. manufacturing sector and reviewed a map showing proposed natural gas liquefaction and export projects in North America. Natural gas liquids feedstocks are plentiful and more affordable, qualities that contribute to the revitalization of U.S. manufacturing and the U.S.'s 2012 shift from importer of liquefied petroleum gases to exporter.

Outlook for Oil Markets

Dr. Currie stated that the global demand for oil and heightened global economic activity support optimism for the U.S. in its role in oil markets. Growth in demand and supply disruptions has recently kept world oil prices relatively high, though a gradual decrease in price (due largely to the anticipated growth in U.S. production) in the next six years is predicted. U.S. tight oil supply has grown in the last several years to now constitute a significant portion of the global supply, and also in that time, there has been unexpected growth in U.S. crude oil production. Some reasons for the optimism for continued growth in U.S. tight oil production are that drilling has become more efficient and that upstream capital spending has grown. Dr. Currie noted that spending associated with the Permian Basin plays will increase oil and natural gas production and economic activity in southeastern New Mexico.

Dr. Currie moved on to a discussion of oil production and prices, gasoline prices and U.S. oil importation, exportation and refining. She reviewed charts showing the fluctuation of oil prices in the past five years and a chart showing the range of prices predicted for the next five years, noting that the breadth of that range is attributed to diverging viewpoints on whether the U.S. will limit its crude oil exports. U.S. oil production is projected to grow and could be relatively high by the end of this decade. Next, Dr. Currie reviewed a chart showing the past and projected delineation by type of U.S. crude oil imports. Importation of light, sour and medium crude imports is projected to decline, while that of heavy crude is likely to stay about the same. On the topic of gasoline prices, Dr. Currie said that they are determined by a global factor: international crude prices, which in turn is influenced by U.S. exports. She added that, if the ability to export crude oil is restricted, then crude oil production will fall. Dr. Currie concluded by highlighting some of the benefits for the U.S. of its crude oil exportation: lower gasoline prices; an improved economy and more jobs; less oil importation; increased governmental revenues; and a stronger geopolitical position.

On questioning, Dr. Currie and committee members addressed the following topics.

Keystone Pipeline. Dr. Currie questioned the judiciousness of delaying development of the most recent phase, XL, of the Keystone Pipeline project and commented that the industry is moving forward with production in spite of related setbacks. She said that if the XL phase were implemented, there would be no direct economic benefit to New Mexico, but rather to the Gulf Coast and the entire U.S.

Gasoline prices. A committee member asked for a list of actions that the legislature could take to help lower gasoline prices. Dr. Currie said that states could play a role in influencing gasoline prices by supporting the campaign to encourage oil exports. She qualified her statement by saying that, while more U.S. exports can lower prices by increasing supply, many other factors influence world oil prices; thus, U.S. export levels and the price of gasoline do not necessarily correspond. Further, although it can take between one and two years for gasoline prices to respond to changes in the level of exports, markets react quickly to large-scale global crises.

Big Brothers Big Sisters (BBBS) of New Mexico — Funding Issue

Chris Garcia, chief executive officer (CEO), BBBS of San Juan County, and Angela Reed-Padilla, CEO, BBBS of Central New Mexico, thanked the legislature for its commitments to appropriating money for the services that BBBS provides and then discussed a funding problem that BBBS is experiencing. In FY 2014, money appropriated for one-on-one mentoring services was not used because of contract and billing issues. BBBS suffered from that lack of funding. Recently, the Department of Finance and Administration (DFA) has again not dispersed money to BBBS. As a result, said Ms. Garcia, BBBS has found it difficult to provide services to a population in critical need. Ms. Reed-Padilla added that the organization's many attempts to reach someone from the DFA and the Governor's Office to discuss the issue have been unsuccessful. A committee member remarked that similar funding problems have been occurring in other parts of the state. David Abbey, director, LFC, recommended that BBBS write a letter to the DFA, with the chairs of the committees copied, explaining BBBS's concern. He added that he would attempt to discuss the issue with the secretary of finance and administration.

Update on Sole Community Provider Federal Compliance

Brent Earnest, deputy secretary, Human Services Department (HSD), Steve Kopelman, director, New Mexico Association of Counties, Jeff Dye, New Mexico Hospital Association (NMHA), Mike Phillips, chief strategy officer, San Juan Regional Medical Center (SJRMC), and Mr. Carpenter presented on issues related to the transition from the hospital-funding Sole Community Provider Program (SCP) to the Safety Net Care Pool Program (SNCP).

Deputy Secretary Earnest provided some history of the issue and context for the discussion. Under the SCP, certain hospitals (those that were the main or only provider of hospital services in their areas or that served as the primary point of access for patients unable to pay for treatment) received federally matched funding for offering certain services. Counties, not the state, paid into the program. The SCP ended at the end of 2012. Under the SNCP, which began on January 1, 2014, less federal money is available, a fact that prompted stakeholders, including the HSD, counties and hospitals to explore and negotiate ways to fill the funding gap.

SB 268 was designed to bring the state into federal compliance with the SNCP and to help fill the program funding gap. Under the new law, affected counties must contribute an amount equal to one-twelfth of their county GRT revenue each year. That amount is less than what counties previously paid for the program. Because of a foreseen deficit in program funding, the state appropriated $9 million for the program. Nonetheless, there remains a $10 million to $12 million funding gap for calendar year (CY) 2014 and anticipated future funding gaps, which need to be addressed. Deputy Secretary Earnest reviewed tables that show program-related expenditures and revenues in FY 2013, those estimated during the legislative session for CY 2014 and updated estimates for 2014. He explained that the revised estimates' increases are attributed to rate increases and Medicaid expansion.

Mr. Kopelman offered additional information and his organization's perspective. The law also provides that certain counties, within a three-year time frame, may impose a one-twelfth or a one-sixteenth GRT increment. As passed by the legislature, SB 268 included a three-year sunset on the county-contribution requirement. The governor vetoed that provision. The NMAC is very concerned about the fiscal implications of that veto. If it remains, counties will be obligated to pay substantially more over time than originally contemplated. This will further stress their budgets, which are already strained by statutory requirements to provide for populations that do not contribute to the revenue stream. Mr. Kopelman commented that the SNCP changes work well in some counties, but not others; among counties, the ratio of program expenditure to revenue is inconsistent.

Mr. Kopelman reviewed some materials provided to the committees: a resolution of the NMAC Detention Administrators Affiliate and charts showing the taxing authorities granted to counties and the counties' exercise of those authorities. Mr. Kopelman asked the committees to increase the appropriation, which has recently fallen below its original level, that reimburses counties for their costs of maintaining detention centers. He also noted that there are 19 different GRTs and 41 increments that counties may impose. Many, like the County Quality of Life GRT, have been implemented seldom or not at all. Often, counties forgo the opportunity to impose increments out of concern for raising the total GRT rate and deterring sales activity or because the laws' provisions are too narrowly drawn. Mr. Kopelman recommended that the committees consider removing counties from the SNCP scheme, which, he argued, is more of a state-based program than the SCP, since it involves Medicaid, a federal program administered by the state. He also said that counties would benefit from tax reform, were lawmakers to scrutinize tax incentives and simplify the system.

Mr. Dye expressed the view that hospitals are moving toward stability. Nonetheless, more work remains to be done, and the NMHA is committed to working with other stakeholders toward a funding solution. He noted that: hospitals are not receiving the quarterly payments that they once did; the federal definition of "uncompensated care" limits the federal match potential and exacerbates hospitals' financial hardship; many smaller hospitals, especially those that are unaffiliated, are at the highest financial risk; and, although Medicaid expansion will help the situation, its effects will not offset other losses. Mr. Dye stressed the need for a funding solution.

Mr. Carpenter testified on the effects for San Juan County of recent developments in hospital funding. He said that the funding gap could have grave consequences for human life. He added that the county's indigent program is bankrupt and that the county can no longer meet its obligations to reimburse medical providers (even at a reduced rate), pay into related funds and pay for inmate medical care. To cope, the county is pursuing cost-control options, including making cuts to providers and reducing services, in spite of having a large population of people in need. Mr. Carpenter stressed that the veto will strain the county.

Mr. Phillips testified that hospitals like the SJRMC must adjust to receiving less money than they did under the SCP and that they are challenged by the inadequacy of funding for uncompensated care.

On questioning, Deputy Secretary Earnest, Mr. Kopelman, Mr. Dye, Mr. Carpenter, Mr. Phillips and committee members addressed the following topics.

Efforts toward finding and implementing a funding solution. The NMAC has taken no formal position on how it wishes to address outstanding issues in the coming session. Although pursuing litigation is a possible recourse, the NMAC would like to discuss with the governor and legislative leadership a solution before 2015. Several committee members urged the stakeholders to strive to reach a mutually accepted solution and not present multiple bills that address the issue. Mr. Dye said that the NMHA is willing to work with the HSD and the LFC.

Problems with the SB 268 line-item veto. Several members questioned the constitutionality of the sunset-provision veto. One also articulated a problem it presents for counties: the authority to tax is limited, but the requirement to pay is not. Moreover, the sunset was inserted into the bill because of uncertainty surrounding the related effects of federal health care reform and Medicaid expansion; it was intended to delay definitive action until there was an opportunity to evaluate the changing situation.

Views about SB 268, as it passed through the legislature. One member commented that SB 268 was not supportable because it did not treat all counties equally; some larger counties were exempted from the contribution requirement. Other members commented that they supported SB 268 because they were told that it was acceptable to counties. Members of the panel responded that, in the course of the legislative process, the original bill had changed in ways that were not agreed to.

County involvement in program funding scheme. Several members expressed the view that, since the state has imposed the requirement that counties provide care, the state should be responsible for paying for that care.

Issues with quarterly payments to hospitals. In response to a member's complaint that some hospitals are cash-strapped from not having received their quarterly payments from the state, Deputy Secretary Earnest said that the HSD is processing applications, which were recently received, for the payments and is striving for uniformity in their handling.

Overview of the Oil and Gas Industry in the San Juan Basin

T. Greg Merrion, president, Merrion Oil and Gas, Jason Sandel, executive vice president, Aztec Well Services, and Tim Smith, senior reservoir engineer, San Juan Basin, Encana Corporation, participated on a panel representing oil and gas producers. Dr. Thomas W. Engler, dean of engineering, New Mexico Institute of Mining and Technology, Jami Bailey, director, Oil Conservation Division (OCD), Energy, Minerals and Natural Resources Department, and Jeri Sullivan Graham, Chemical Diagnostics and Engineering Group, Los Alamos National Laboratory (LANL), participated on a panel focusing on regulatory issues.

David Martin, secretary of energy, minerals and natural resources, introduced the discussion with an overview of the oil and gas industry in New Mexico. He outlined some key employment and economic data related to the industry, highlighting the percentage (about 31%) of contributions from the industry to the general fund. In the last six years, oil production has constituted an increasing share of the total contributions from the oil and gas industry to the general fund. Secretary Martin reviewed a chart showing, over the last decade, the production value in dollars of oil production, gas production and the two combined. Through other graphics, he pointed out the production value to counties of the oil and gas industry and oil- and gas-derived revenues to counties. Secretary Martin finished by drawing the committees' attention to charts showing, over the last decades, the general stabilization of natural gas production and prices and the dramatic increase in crude oil production and noting that it is unknown when oil production will level off.

Producer Panel

Mr. Merrion discussed the Mancos shale play and oil and gas production in the San Juan Basin. About 10 years ago, the combination of hydraulic fracturing and horizontal well drilling technologies replaced that of vertical well drilling, spurring a natural gas production boom. Mr. Merrion reviewed illustrations of: the shale plays in the U.S.; Mancos shale plays; a cross-section of the San Juan Basin; and Mancos oil, wet gas and dry gas windows. He said that the deepest part of the San Juan Basin contains dry natural gas, while the shallow part of it contains wet natural gas and a shallower part of it contains oil. About 5% of the nation's natural gas comes from the San Juan Basin. Mr. Merrion reviewed charts showing: the 11 rigs running in the San Juan Basin; crude oil settlement prices; and natural gas settlement prices. He concluded by making the following points about the Mancos shale play: the first "sweetspot" in the Mancos shale play has been identified, and it is believed that more exist; drilling activity is increasing; drilling and completion techniques for mining oil and gas from shale are being honed; federal and tribal, but not state, permitting is slow; the limited refining capacity could present market problems; four area Indian reservations appear to have the potential for energy extraction; and development is still in its nascent stage.

Mr. Sandel began his presentation by introducing the committees to several of his company's employees, who were in the audience, and stressing that the oil and gas industry supports many people's livelihoods by creating and sustaining well-paying jobs. He offered a brief background of his family's 50-year old company, noting in particular its substantial growth between 1999 and 2008; its recession-induced contraction; its recent expansion and near-return to 2008 employment levels; and its commitment to providing employee benefits. Mr. Sandel reviewed charts showing the rig count in New Mexico and the San Juan area and said that most of the industry's recovery has occurred in the southeast part of the state. The production declines have reduced Farmington's and Aztec's GRT revenue by about 25%. Mr. Sandel said that most future energy development in the region will be in oil, not natural gas. He finished by listing some challenges for the industry in the region, which include: inadequacy of transportation infrastructure; slowdowns in getting federal permits; the availability of a competent work force; and New Mexico-based companies' access to capital.

Mr. Smith presented the committees with illustrations of the Gallup and Mancos oil fairways and a cross-section of a horizontally drilled well, and he talked about Encana's activity in New Mexico. The company was the first in the San Juan Basin to drill an oil well. Encana has over 60 horizontal wells, a $350 million investment and a working interest in 176,000 net acres. It employs what Mr. Smith characterized as responsible practices, including using a closed-loop drilling system, voluntarily sampling ground water, minimizing air emissions, using multi-well pads and attempting to reuse produced water. Mr. Smith referenced some challenges for resource extraction that Encana faces: permitting delays, interference from federal rulemaking processes, oil price fluctuations, the availability of services (such as water and sand) and take-away capacity (i.e., transportation). He highlighted some of the economic and community benefits that the company brings to the northwest part of the state in particular, including investments, taxes, royalties and support of community institutions.

Regulatory Panel

Dr. Engler gave an overview of hydraulic fracturing (which he defined as "the injection primarily of water and sand under high pressure into the producing formation, [which creates] fissures in the rock that allows a pathway for oil and gas to migrate to the wellbore") in New Mexico. He compared modern extraction techniques with those from the past, which were effective but hazardous, and explained how fresh water around the drill site is protected. Steel casing and cement form a barrier between the well and the drinking water aquifer. Dr. Engler noted that, unlike some states, New Mexico has an agency regulating well construction and integrity. He continued by identifying the composition of frac fluid as all but .5% water and sand, with that .5% being chemicals, the disclosure of which is required by state and federal law, that are commonly used in the home. Addressing the topic of water use in the Mancos/Gallup horizontal well play, Dr. Engler compared 2013 water-use levels to annual ground water withdrawals from the upper Colorado River Basin of New Mexico: 137 acre-feet for the former, and about 4,000 acre-feet for the latter. Compared to other energy-production methods, the amount of water used to produce deep shale natural gas is relatively low. Dr. Engler listed some measures taken to mitigate water use, including using nitrogen foam, recycling and exploring the use of deep, brackish saline water. Dr. Engler ended his presentation by describing the industry's New Mexico-based production and its effects on employment and state revenue.

Ms. Bailey reviewed the OCD's mission and administrative structure. She highlighted the industry's active well counts in the state (as of June, over 27,000 oil wells and over 28,000 gas wells) and state production totals (in 2013, 99.6 million barrels of oil and 1.22 trillion cubic feet of gas). In 2008, there were about the same number of oil and gas wells, but in 2013, the number of oil wells exceeded that of gas by a multiple of about eight to one. The total number of wells in those years is approximately equal. Ms. Bailey reviewed charts showing gas production levels in the state over the last 44 years and noted a spike, concentrated in southeast New Mexico and attributed to horizontal drilling, of oil production. Gas production, historically, has been concentrated in northwest New Mexico. Ms. Bailey shifted to the topic of administrative performance and actions, saying that the OCD faces difficulties with employee recruitment and retention. She reviewed some of the regulatory actions that the OCD has taken, which include amending the pit rule and promulgating the horizontal well rule and the hydraulic fracturing disclosure rule, and OCD duties, plans and goals. The OCD plans to make requirements of the acid gas injection rule more uniform, amend the produced water use and reuse rule and simplify the surface water management facilities rule. Ms. Bailey said that the OCD aims to increase staff, treat stakeholders more fairly and improve transparency in all actions. In closing, she encouraged the committees to learn more through web-based OCD resources.

Ms. Sullivan Graham spoke about brackish water use and produced water recycling, noting first the nexus between water and energy: each is required to produce the other. Drought recurrence has become the norm in New Mexico, she said, which means that planning is needed. To conduct some of this planning, a task force on drought, chaired by the state engineer, was formed; it undertook a recoverable water initiative that is being pursued by two subcommittees and work groups: one focused on brackish water and the other on produced water. The brackish water work group consists of specialists from the public and private sectors. That group identified some key challenges in using brackish water: availability, cost, infrastructure, investment, risk perception, environmental sustainability, legal impediments and inter-entity cooperation. Ms. Sullivan Graham then described the group's planned next steps, which are to gather appropriate data, coordinate with other entities and seek out resources. She then turned to the topic of produced water, which is regulated as a waste but can provide a consistent, stable source of water. She described what is needed to reuse produced water — infrastructure and treatments — and identified some steps in reaching the goal of its reuse: adapting state regulations; building infrastructure; exchanging information; and measuring results, benefits and impacts. Ms. Sullivan Graham continued by mentioning two other major efforts under way to explore the water-energy nexus: a U.S. Department of Energy Water Energy Tech Team and its development of a Water Energy Program plan; and a LANL and Sandia National Laboratories Southwest Energy-Water Challenges and Strategy meeting.

On questioning, the panels and committee members addressed the following topics.

Transportation infrastructure. The roads in southeast New Mexico are deteriorating from heavy use brought on by the energy boom there. As a result, there are more traffic accidents. Tom Church, secretary of transportation, who was in the audience, responded by saying that not enough money is available to pay for that area's and northeast New Mexico's needed road projects. He added that impending shortfalls in federal and state road funding will further exacerbate the problem. A committee member commented that, since much severance tax revenue derives from southeast New Mexico, more of that revenue should be appropriated there. Several members expressed the view that the transportation-infrastructure problem is acute, that solutions should be explored and that one or more of those solutions should be pursued.

The future of oil and gas extraction techniques. Mr. Merrion commented that the technologies for mining hydrocarbons from source rock have improved and will probably continue to become more effective. Mr. Smith asserted that those technologies will improve.

Intrastate oil shipping. A committee member requested more information about the safety measures in place for shipping crude oil throughout the state.

Aquifer and fresh water depletion. Ms. Sullivan Graham reported that, in some parts of the state, water from aquifers has declined precipitously despite years of rainfall because extraction has exceeded recharge. Water supplies might be supplemented with brackish water, but only if that water is treatable.

There being no further business, the RSTP adjourned at 3:58 p.m.